

A REVOLUTION IN DOMESTIC FINANCES

BY BRIAN WILSON, C.A.

ON MARCH 1, 1986, the Family Law Act 1986 (FLA), came into force in Ontario, bringing with it sweeping changes to the division of property on marriage breakdown or death. These changes will affect all married people living in Ontario and their financial relationships with third parties. It will also have some impact on support obligations for married and common law spouses.

Under the FLA, on breakdown of a marriage, one spouse could conceivably become a shareholder (or partner) in the other spouses business or be given an entitlement to a share of its profits. A surviving spouse may elect to take an entitlement under the FLA instead of accepting what is left under the deceased spouse's will. This could result in assets not being distributed according to a person's wishes on death and also result in insurance companies being hesitant to advance life insurance proceeds until the surviving spouse has made the choice between the FLA entitlement and the will.

The basic principle under the FLA is that the value of all property accumulated during the marriage will be divided equally upon the termination of the marriage, subject to certain deductions and exclusions.

Each of the provinces has its own legislation to deal with the division of property on marriage breakdown. There are similarities in the systems. For example, in Alberta, Saskatchewan and Manitoba, each spouse retains separate property during marriage but on its breakdown can claim an equal division of all assets acquired during the marriage. However, in Quebec, all assets acquired by either spouse during the marriage are jointly owned from the date of acquisition.

Historical Perspective

Under the common law, each spouse owns separately the property that belonged to him or her prior to marriage. Any property purchased subsequent to marriage remains with the spouse who paid for it. Thus, the wife who maintains the family household, and cares for the children, but does not earn an income or acquire significant assets is often left without a share of the family property. The Family Law Reform Act was introduced in 1978 to correct this injustice. Under the Family Law Reform Act, each spouse had an equal right to "family assets" - regardless of which spouse owned them. "Family assets" included all matrimonial homes and property used by both spouses for shelter, transportation and recreational and social purposes. Other assets (e.g. partnership or business interests, personal stock portfolios) were not considered family assets unless it was inequitable that a division not be made.

The FLA was introduced to provide for "the equitable and orderly transfer" of all assets and to recognize that marriage is essentially a form of partnership.

Division of Net Family Property

A "division" of property is triggered by marriage breakdown or death. Each spouse is entitled, by one of these events, to share equally in the value of the net family property (NFP).

To effect this, the FLA may require one spouse to make an equalization payment to the other spouse. The amount of the equalization payment will equal one-half of the difference in the NFPs of the two spouses. The form of the equalization payment will vary as neither spouse is entitled to any specific asset - only to share in the value of the NFP.

Net Family Property

NFP represents the value of each spouse's property, net of any liabilities. The definition of property under the FLA includes property of any nature or kind, including any interest, present or future, vested or contingent, in real or personal property. Thus, the value of pension plans, deferred profit sharing plans, partnership interests and contingent interests in estates or trusts would be included in NFP.

The value of the NFP is determined for each spouse as at the date of marriage breakdown or the day before death. It is reduced by the value of the NFP of the spouse at the date of marriage. Only the following are excluded from NFP:

1. Gifts or inheritances from third parties after the date of marriage (other than the matrimonial home);
2. Income from property in number 1, if the donor or testator expressly stated that such income is to be excluded from the spouse's NFP;
3. Damages or rights to damages for personal injuries and marital stress;
4. Proceeds or rights to proceeds of a life insurance policy;
5. Property, other than the matrimonial home, into which property in numbers 1 to 4 can be traced; and
6. Property that the spouses have agreed (by a domestic contract) to exclude from NFP.

Equalization Payments

The spouse with the larger NFP is required to make an equalization pay-

ment to the spouse with the lower NFP. The equalization payment equals one-half the difference in their NFPs.

For example, a medical student (husband) marries and neither has any assets or liabilities when they marry except for \$50,000 of CSBs that the wife inherited some years before. When the husband obtains his medical degree, he starts a medical research business. The wife stops working to raise a family. Five years later, their marriage breaks down. The wife's CSBs are now worth \$200,000. His business is worth \$1,000,000 and the family home, which he purchased for \$400,000 is now worth \$500,000 and has a mortgage of \$250,000 outstanding on it.

Wife's NFP:	
Value of CSBs	\$200,000
Less net property brought into the marriage	50,000
	\$150,000

Husband's NFP:	
Value of business	\$1,000,000
Less - mortgage	250,000
- net property brought into the marriage	NIL
	\$750,000

The husband must make an equalization payment of \$300,000 (being one-half of \$750,000 - \$150,000). If it was agreed that the wife would take the matrimonial home, the equalization payment would be reduced to \$50,000 (\$300,000 less 1/2 x \$500,000 (being the value of the home)).

The court may order the following:

1. cash payment;
2. transfer of property, absolutely, for life or a period of years;
3. sale of any property;
4. security be pledged (including a charge or lien on property); or
5. if necessary to avoid hardship, instalment payments for a period not exceeding ten years.

Death

Death of a spouse may also trigger an equalization payment. A surviving spouse may elect to take under the will or to receive an equalization payment (as calculated above).

If a surviving spouse elects to claim the equalization payment, the surviving spouse is deemed to have disclaimed the right to receive any insurance proceeds.

As the surviving spouse has six months from the date of death to elect, insurance companies are unlikely to advance proceeds from policies without receiving a waiver from the surviving spouse.

Domestic Contracts

The impact of the FLA may be modified by spouses entering into domestic contracts. Spouses may agree to omit certain property from one spouse's NFP. However, domestic contracts cannot alter a spouse's rights to a matrimonial home.

Impact

The financial costs of marriage breakdown and death will continue to be significant.

In determining NFP, a valuation must be done of the net assets at the date of marriage and at the date of marriage breakdown or death. Given that presently one-third of marriages end in marriage breakdown and two-thirds on the death of a spouse, professional valuers will be in high demand. Their task will, no doubt, be complicated by people who do not maintain good records of their financial activities (or do not bother to value their assets at marriage in contemplation of marriage breakdown). Undoubtedly, differences of opinion as to the value of NFP will lead to litigation.

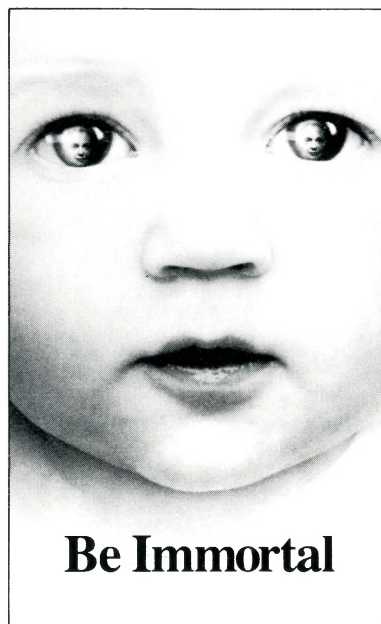
Third parties will now have a significant interest in the marital affairs of their business partners. The NFP provides that no court order shall require the sale of an operating business or farm or seriously impair its operation - unless there is no reasonable alternative. Thus the courts may order a sharing of profits, transfer of shares to a spouse or issuance of shares by a corporation to a spouse to satisfy an equalization payment. Potentially, a partner's ex-wife could become a new partner in the business.

Lenders will also be concerned that a lien on assets to satisfy an equalization payment may have priority over their claims.

Conclusions

Domestic contracts, which are common in Quebec, will likely become quite prevalent in Ontario as this is the only means of altering the impact of the FLA. People contemplating marriage should enter into domestic contracts and review their wills with a professional advisor. Married people should also review their wills with a professional advisor and consider entering into domestic contracts.

Mr. Wilson is a tax manager in the Toronto office of Clarkson Gordon Chartered Accountants.



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